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Tax News Alert

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Dear Friends and Clients
We are pleased to update you with selected Israeli tax developments for the third quarter of 2019

Selected Issues:

- **Transfer pricing: What to declare to the Tax Authority – a new form in your tax return.**
- **Voluntary Disclosure - taxation on capital as part of the Voluntary Disclosure Procedure by the Tax Authority is legitimate.**
- **VAT - service provision to foreign residents on an e-commerce marketing website is subject to full VAT.**

Sincerely,
Artzi, Hiba, Elmekiesse, Cohen - Tax Solutions Ltd.

Tax News Alert No.35 – November 2019

Dear friends,

The Artzi, Hiba, Elmekiesse, Cohen - firm is committed to the highest level of services. We keep our clients and colleagues, in Israel and abroad, fully up to date with respect to recent developments in the Israeli tax law and their implications.

We would like to thank you for using our services and for your kind cooperation which enables us to offer you high level tax solutions. It would be our professional, as well as our personal honor to continue cooperating with you.

Transfer pricing: What to declare to the Tax Authority – a new form in your tax return

Lately, the Israeli Tax Authority published a new form - Declaration of International Transaction that comes as an appendix to the annual tax return. The form serves the Tax Authority in identifying and addressing international transactions where related parties are involved. The form combines the Israeli tax legislation concerning transfer pricing and the Tax Authority's circulars reflecting its position on the subject.

The Tax Authority previously published two income tax circulars on transfer pricing:

- Circular 11/2018 addresses operations related to high - risk distribution (comprehensive distribution), low-risk distribution and marketing activity with cost margin pricing.
- Circular 12/2018 establishes a "green channel" for cases within the profitability range set by the Tax Authority, whereby those meeting the criteria obtain a relief from the reporting requirements (market research). The latter addresses activity related to low-risk distribution, marketing activity with cost margin pricing as well as service with low added value.

When filling out the new form, explicit indication of whether or not the circular applies is made by checking off one box from several options. By indicating that the circular applies, the taxpayer is exempt from the need to perform a full

market survey. Accordingly, explicit indication is necessary showing whether the transaction price meets the terms of the circular as per the selected method (low value services, marketing services or distribution services) - this is a fixed list in which one box must be selected to indicate whether or not the instructions of the circular have been carried out. **With regards to the transaction details**, the following descriptions are required:

1. **Transaction description.** For the sake of clarity an indication must be made whether the transaction is income or expenditure.
2. **Method employed.** In the previous form the method was not indicated in a separate category but as part of the transaction price in the comments section. It seems that the Tax Authority wishes to ascertain that the taxpayer submitting the return declares that transfer pricing regulations have been carried out.
3. **Profitability rate.** The taxpayer must declare whether the market research terms have been met as per the transfer pricing regulations.
4. **Transaction amount.** The words "as indicated in financial reports" have been added as a note - the need to cross - validate reporting in the form with the financial reports is an outcome of, inter alia, Supreme Court Case regarding stock options for employees of Israeli enterprises that report using the cost plus method.

To sum things up - the standard of reporting, the reliance on the financial report and the responsibility of the person submitting the report has jumped up a level, in particular where the submitter must determine a priori for certain transactions whether or not the conditions of the circulars are met, a determination which is sometimes subject to interpretation.

Voluntary Disclosure – taxation on capital as part of the Voluntary Disclosure Procedure by the Tax Authority is legitimate

Over the last decade many Israeli residents have sought to settle previously unreported accounts of foreign-held assets and the income generated by them with the Tax Authority. This was typically performed by a formal petition to the Tax Authority via the Voluntary Disclosure Procedure. The procedure has changed over the years, has been extended periodically, and even allowed for submission of anonymous requests and negotiations until an arrangement was reached.

Our firm has been involved in many of these petitions and arrangements and has witnessed the changes that have taken place over the years regarding a significant issue in these arrangements,

namely - should taxation apply to the "capital", and if so, at what tax rate.

The subject of taxation on capital has been addressed in a July 14, 2019 court ruling in the case of Avner Nukrai (Class Action Case 16-05-5356), where the petition to recognize the case as a class action suit was denied. As the basis of the claim, the claimant maintained that taxation on years where the statute of limitations has expired should not apply; that is, those tax years that preceded the ten years before reporting.

As to the statute of limitations, the court ruling included the following:

- Don't mix apples and oranges - that is, you cannot infer from a statute of limitations on the criminal offense of tax evasion on income generated over ten years ago, to a statute of limitations on a civil matter (tax collection).
- Despite this, however, the Tax Authority is not authorized to collect taxes without a time limit; there are limitations of reasonability and conditions of adherence to the rules of administrative law. The judge states that **the taxpayer has already received consideration in the form of immunity from criminal trial, thus the demand to also tax income generated more than ten years prior is a reasonable one.**
- Nor shall the statute of limitation apply to the case of someone who submitted a tax return but failed to include a significant portion of his income in it.

The judge claims that in accepting the claim while retaining the immunity from criminal charges, there is an **egregious violation** (emphasis in the original!) of the delicate balance at the foundation of the Voluntary Disclosure Procedure, and this claim displays a lack of good faith.

We believe that there's good news in this ruling, despite denial of the request; specifically the possibility of taxation of income for the years in which the statute of limitations has expired. What follows from the ruling is that while the Voluntary Disclosure process grants immunity from criminal charges, taxation of income from more than ten years prior is legitimate. We believe this is not the case in standard civil tax assessment procedures; as long as the taxpayer was not convicted of a crime or paid a forfeiture, he will not receive a tax assessment and the Tax Authority will not be authorized to tax him on the years preceding the statute of limitations. This would certainly apply to cases where non - reporting on past income was due to error or was not a result of premeditated planning and intent.

We'd like to take this opportunity to remind you that the current Voluntary Disclosure Program will expire at the end of 2019 and the Tax Authority has already announced that it does not anticipate an extension or a renewed program.

VAT – service provision to foreign residents on an e-commerce marketing website is subject to full VAT

The Tax Authority has just published a tax ruling (decision 4429/19), about VAT obligations for services rendered to a foreign resident via operation and management of a website advertising products of foreign suppliers abroad that provides links (affiliation) to the supplier websites abroad for purchase.

The taxation decision states that full VAT applies to income from these services despite the rule that a zero rate VAT applies to services provided to foreign residents.

The case in question applies to an Israel - resident company that provides marketing and mediation services via a Hebrew website targeting Israeli consumers - for foreign enterprises (the "operating companies"), who provide marketing services to foreign retail enterprises (the "suppliers"), who sell products.

The website includes a search engine and is intended for Israeli customers, allowing content on goods from online stores of the suppliers to be accessible to them in Hebrew (e.g. product images, prices, return policies, shipping). Website management, including the content presented, operations, support and updates are all the responsibility of The Company. An Israeli client who wishes to purchase an item clicks on a link on the website and is transferred to the sales website of the relevant supplier. From this point on, all activity takes place at the supplier website, directly between the customer and the supplier. Terms of service agreements and transactions for the purchase of goods take place directly on the supplier websites between the suppliers and the Israeli customer. The goods do not belong to the Company at any point.

In exchange for services rendered, the Company receives from the operating companies a fee derived from total purchases and as a function of the entry volume of Israeli customers to the supplier websites

The Company requested that the fee paid by the operating be taken as a fee for services provided to a foreign resident (the foreign operating companies), and as per the VAT Law, zero VAT would then apply.

The tax ruling holds that, although the service is provided to a foreign resident, according to the exception established in the VAT Law: "...services shall not be considered to be provided to a foreign

resident when the subject of agreement is service provision that in practice, in addition to the foreign resident is also provided to an Israeli resident in Israel..." - and according to the decision, the Israeli-resident end customers should be viewed as ones who receive services from the enterprise as well - thus zero VAT would not apply, and the enterprise must produce an tax invoice for the full VAT rate to the operating companies on the full sum of the fee obtained. However, the tax ruling determines that if it can be proven that the price of import of the goods includes the company's fee, then fthe relief should apply, with zero VAT. Since these are issues of e-commerce - the Tax Authority emphasizes in this decision that the indicated exemption (as a result of the fee being included in the product cost for customs purposes) only applies when the overall price of the product required reported for customs purposes by the Israeli customers and requiring import taxes in practice. That is - the relief will not apply when the import price is low, below the ceiling price for import tax exemption.

Some insights

- First, we maintain that the exception by which zero VAT applies to services for foreign residents, even if those services were also given in practice to an Israeli resident in Israel, applies across the board and does not depend on VAT charge or import tax in practice.
- Second, we would like to distinguish between two cases - the first is the case brought down in the decision, whereby it can be claimed, as the Tax Authority claims, that the service is dual both for the foreign resident requesting the service and the specific Israeli resident who surfed the website, researched the product and then chose to click on the link and execute the purchase himself on the supplier's website. The second case would be a marketing website of an Israeli resident who only advertises products of foreign suppliers - and they may contain much detail and information - but the purchase, if it takes place, is completely independent from the advertising website. It is clear to us that the latter case is general advertising, reaching out to the general public (albeit Israeli), and no individual Israeli customer is identified as the recipient of service. In this case, we believe zero VAT should be granted on the fees for advertising services received from the advertisers, who are foreign residents.

In case you have any questions or need further clarifications, please do not hesitate to contact our International Taxation Team:

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Any implementation, which is based on the information provided herein, should only be performed after obtaining professional and specific consultation.

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